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In the Supreme Court of the United States

OCTOBER TERM, 1987

INVESTMENT COMPANY INSTITUTE, ET AL.,
PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORP., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether federal law prohibits state-chartered banks that are not members of the Federal System from becoming affiliated with firms that engage in the securities business.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-18a) is reported at 815 F.2d 1540. The opinion of the district court (Pet. App. 39a-44a) is reported at 606 F. Supp. 683.

JURISDICTION

The judgment of the court of appeals was entered on April 7, 1987. The petition for a writ of certiorari was filed on July 6, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Banking Act of 1933, ch. 89, 48 Stat. 162, contains four provisions, usually referred to together as the Glass-Steagall Act, that restrict the participation of banks and certain bank affiliates in specified securities activities. See *Securities Industry Ass'n* v. *Board of Governors*, 468 U.S. 207, 216 (1984). Section 16 of the Act, 12 U.S.C. (Supp. III) 24 Seventh, limits the authority of *national banks* to deal in securities. Sections 20 and 32 of the Act, 12 U.S.C. 377 and 78, restrict the affiliate activities of banks, both federally- and state-chartered, that are *members of the Federal Reserve System.* Section 20 provides that "no member bank shall be affiliated in any manner" with firms "engaged principally" in the underwriting or distribution of securities; Section 32 provides that no director, officer or employee of a firm "primarily engaged" in the underwriting or distribution of securities "shall serve [at] the same time as an officer, director, or employee of any member bank."

Section 21 of the Act, 12 U.S.C. 378, is the only provision that applies to state-chartered banks that are *not* members of the Federal Reserve System, as well as to national and state member banks. Like the other provisions of the Act, Section 21 "separates investment and commercial banks, but does so from the perspective of investment banks." *Securities Industry Ass'n*, 468 U.S. at 148. It prohibits any person "engaged in the business of issuing, underwriting, selling, or distributing * * * stocks, bonds, debentures, notes, or other securities" from "engag[ing] at the same time to any extent whatever in the business of receiving deposits" (12 U.S.C. 378(a)(1)). Willful violations of Section 21 are punishable by fine or imprisonment (12 U.S.C. 378(b)).

2. In 1984, after two years of consideration and two rounds of rulemaking proceedings, the Federal Deposit Insurance Corporation (FDIC), which regulates federally-insured state banks that are not members of the Federal Reserve System (insured nonmember banks), issued regulations permitting such banks to become affiliated with firms engaged in the securities business. In a 1982 statement of policy (Pet. App. 189a-193a), the FDIC explained that the Glass-Steagall Act does not prohibit insured nonmember banks from establishing affiliates or organizing subsidiaries that engage in the securities business. The FDIC noted that Section 21, the only provision of the Act that applies to nonmember banks, "does not address the actions of subsidiaries or affiliates" (Pet. App. 191a). In contrast, Sections 20 and 32 of the Act, which regulate affiliations between banks and securities firms, apply only to member banks (*id.* at 191a-192a). The FDIC accordingly concluded that it should not "extend[] the reach of the prohibitions of section 21 of the Glass-Steagall Act to *bona fide* subsidiaries of insured nonmember banks" (Pet. App. 193a)—a conclusion that the agency believed was supported both by the Glass-Steagall Act's legislative history and by this Court's decision in *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46 (1981).

The FDIC, however, also recognized its responsibility for maintaining the safe and sound operation of insured nonmember banks (see Pet. App. 190a). It therefore promulgated a regulation providing, among other things, that the securities affiliates and subsidiaries of such banks must be physically separated from the bank, must conduct their business according to wholly independent policies, and must observe sepa-

rate corporate formalities; affiliates and subsidiaries also must make it clear to customers that recommended investments are not bank deposits, are not guaranteed by the bank, and are not insured by the FDIC. At the same time, potentially risky bank activities, including purchases of securities from and extensions of credit to affiliated or subsidiary securities firms, are severely restricted. 12 C.F.R. 337.4 (e). And a bank's creation of a subsidiary relationship with a securities firm must be promptly disclosed to the FDIC. 12 C.F.R. 337.4(d).[1]

3. Petitioners, trade associations that represent investment companies and securities dealers, then filed this action challenging the regulation under both Section 21 of the Glass-Steagall Act and the Federal Deposit Insurance Act (12 U.S.C. 1181 *et seq.*). The United States District Court for the District of Columbia rejected this challenge, upholding the regulation (Pet. App. 39a-44a). The court noted that petitioners' argument reduced to the assertion that Section 21 bars insured nonmember banks from entering into a parent-subsidiary or affiliate relationship with a securities firm. But such a reading of Section 21, the court continued, would render nugatory Section 20, which specifically regulates the affiliate relationships of *member* banks. Because petitioners' approach would lead to this "contradictory" result—and because Section 21, as a criminal provision, should be narrowly construed—the court found the regulation consistent with the Glass-Steagall Act.

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[1] The FDIC recently issued proposed amendments to portions of the regulations dealing with common names of affiliated banks and securities firms, and common entrances to bank and affiliated securities firm facilities. 52 Fed. Reg. 11492 (1987).

The court of appeals affirmed (Pet. App. 1a-18a), finding that "Congress clearly intended § 21 to allow insured nonmember banks to maintain subsidiary or affiliate relationships with securities firms" (*id.* at 11a).[2] The court noted that Section 21, the only provision of the Glass-Steagall Act that regulates nonmember banks, "says nothing explicitly" about the propriety of such banks "establishing subsidiaries or affiliates that engage in the securities business" (Pet. App. 12a). And if the provision is read to regulate such relationships, the court continued, "then § 20's somewhat permissive language, which allows *member* banks to establish affiliate relationships with firms doing some limited amount of securities work [that is, firms not "principally engaged" in the securities business], becomes meaningless" (*id.* at 13a).

Petitioners attempted to avoid this conclusion by arguing to the court of appeals that Section 20 is a permissive provision that creates a limited exemption for member banks from the general prohibition on affiliation with securities firms supposedly imposed on all banks by Section 21. The court explained, however, that Section 20 "speaks in the language of prohibition, not authorization" (Pet. App. 13a). The court also found it "utterly improbable" (*id.* at 15a) that Congress intended to impose greater restrictions on nonmember than on member banks, noting that many members of Congress had considerable doubt at the

[2] Petitioners simultaneously filed both their district court action challenging the regulation and a petition for review of the regulation in the court of appeals (Pet. App. 5a). The court of appeals stayed proceedings on the petition for review pending the district court's decision (*ibid.*), and ultimately affirmed the district court's decision while dismissing the petition for review (*id.* at 18a).

time of the enactment of the Glass-Steagall Act about Congress's authority to regulate nonmember banks at all (see *id.* at 12a, 14a-15a). And the court of appeals found compelling support for its holding in this Court's decision in *Board of Governors* v. *Investment Co. Institute, supra,* which held under Section 21 that " 'bank affiliates may be authorized to engage in certain activities that are prohibited to banks themselves' " (Pet. App. 15a-16a (quoting 450 U.S. at 60)).

The court of appeals also rejected petitioners' contention that the FDIC regulation is inconsistent with provisions of the Federal Deposit Insurance Act prohibiting "unsafe and unsound banking practices" (see 12 U.S.C. 1818, 1816).[3] The court explained that this contention rested on the incorrect assumption that the challenged regulation is invalid under Section 21 of the Glass-Steagall Act (Pet. App. 17a). And the court added that, in any event, "[a]uthority to determine what constitutes an 'unsafe' or 'unsound' banking practice is firmly committed to the [FDIC]" (*id.* at 18a). Here, the court concluded, petitioners have provided "no rationale that demonstrates the 'unreasonableness' of FDIC's decision to impose stringent regulations on insured nonmember banks' affiliate and subsidiary relationships with securities firms, in lieu of pursuing an outright ban on such relationships" (*ibid.*).

[3] The court of appeals originally held that petitioners lacked standing to assert claims under the Federal Deposit Insurance Act (see Pet. App. 27a-30a). The court of appeals vacated this portion of its holding after this Court's decision in *Clarke* v. *Securities Industry Ass'n,* No. 85-971 (Jan. 14, 1987) (see Pet. App. 9a-10a), and proceeded to reject petitioners' claim on the merits.

ARGUMENT

The decision below is correct: it is unambiguously supported by the language and legislative history of the Glass-Steagall Act, as well as by this Court's decision in *Board of Governors* v. *Investment Co. Institute*, 450 U.S. 46 (1981). In the absence of a conflict in the circuits, review of the holding below plainly is not warranted.

1. a. Petitioners' principal legal contention (Pet. 12-13) is their assertion that Section 21's plain terms bar the subsidiaries and affiliates of insured nonmember banks from dealing in securities. This assertion, however, is an insupportable ipse dixit. In fact, Section 21 prohibits "any person, firm, corporation, association, business trust, or other similar organization, engaged in the [securities business]" from "engag[ing] at the same time to any extent whatever in the business of receiving deposits." The "to any extent whatever" phrase, upon which petitioners rely, simply provides that securities firms may not accept any deposits in any form. See 77 Cong. Rec. 4179 (remarks of Sen. Bukley). Nothing in Section 21 has any bearing on the authority of insured nonmember banks to establish bona fide affiliate or subsidiary relationships with securities firms, so long as those firms do not engage in the business of receiving deposits.

As both courts below recognized, Congress's decision to exclude affiliate and subsidiary relationships from the reach of Section 21 is confirmed by the fact that other provisions of the Glass-Steagall Act expressly address the affiliations of *member* banks. Section 20 provides that "no member bank shall be affiliated in any manner" with a firm engaged principally in issuing, underwriting or distributing securities, while Section 32 prohibits interlocking managements

between such banks and securities firms. When Congress wanted to address bank affiliations, it thus did so in express terms. Indeed, petitioners' reading of Section 21 would render Section 20 meaningless, a result that could not have been intended by the Congress that simultaneously enacted both provisions.[4] And the legislative history makes clear, as the language of these provisions suggests, that Congress acted deliberately in declining to regulate affiliate relationships in Section 21: in the only direct congressional commentary on the provision, Senator Glass responded "[y]es" when asked whether, "if [investment banks] wish to receive deposits they must have separate institutions for that purpose." 77 Cong. Rec. 3730 (1933) (colloquy between Senators Glass and Robinson).

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[4] Petitioners' only answer to this proposition is the assertion that Section 20—which permits member banks to affiliate with firms that do some securities business, so long as those firms are not "principally engaged" in the securities business—was intended to create a special exception for the benefit of member banks to the otherwise general prohibition created by Section 21 (Pet. 15-16). As the court below noted, however, this "utterly improbable" assertion turns the Glass-Steagall Act on its head. Absolutely nothing in the language of Section 20 suggests that it was written as a permissive exemption rather than as an independent prohibition (see Pet. App. 13a-14a). Such a reading, moreover, would mean that member banks are subjected to less stringent regulation than nonmember banks. That would fly in the face of Congress' express intent not to "discriminate, in any manner, against State nonmember, and in favor of, national or member banks" (§ 8, 48 Stat. 180). And it is hardly a likely reading, given the doubts expressed by some sponsors of the Glass-Steagall Act that Congress had the power to regulate nonmember banks at all. See 75 Cong. Rec. 9905 (1932) (remarks of Sen. Fess); *ibid.* (remarks of Sen. Walcott); Pet. App. 12a.

b. The holding below also follows directly from this Court's decision in *Board of Governors* v. *Investment Co. Institute, supra,* an earlier challenge to bank activities brought by one of the petitioners in this case. Noting that "a bank affiliate may engage in activities that would be impermissible for the bank itself" (450 U.S. at 64), the Court there held that bank holding companies—which are defined as bank affiliates for purposes of the Glass-Steagall Act (see 12 U.S.C. 221a(b)(4))—may offer certain securities-related services even if Section 21 would bar banks from performing those services (450 U.S. at 63-64).[5] In reaching this conclusion, the Court flatly rejected the assertion that "the bank and its holding company should be treated as a single entity for purposes of applying §§ 16 and 21," finding that "the structure of the Glass-Steagall Act indicates to the contrary." The Court explained: "Sections 16 and 21 flatly prohibit banks from engaging in the underwriting business. Organizations affiliated with banks, however, are dealt with by other sections of the Act [among them, Section 20]. * * * Thus the structure of the Act reveals a congressional intent to treat banks separately from their affiliates. The reading of the Act urged by respondent would render § 20 meaningless."

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[5] The Court noted that "Section 21 prohibits firms engaged in the securities business from also receiving deposits. Bank holding companies do not receive deposits, and the language of § 21 cannot be read to include within its prohibition separate organizations related by ownership with a bank, which does receive deposits" (450 U.S. at 58 n.24). The Court added that the legislative history of Section 21 supports this conclusion (*ibid.*) (citing 77 Cong. Rec. 3730 (1933) (colloquy between Senators Glass and Robinson)).

450 U.S. at 58-59 n.24. This holding is dispositive here.[6]

In contrast, the two decisions of this Court relied upon by petitioners (Pet. 14-16), *Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971), and *Securities Industry Ass'n* v. *Board of Governors*, 468 U.S. 137 (1984), are wholly inapposite. *Camp* involved a national bank's operation of a mutual fund, an activity that is unlawful for banks under Sections 16 and 21; deferring to a conclusion of the Federal Reserve Board, the Court concluded that the bank and its fund were *not* separate entities (401 U.S. at 626 n.12). See 12 C.F.R. 218.111(j). *Securities Industry Ass'n* held only that commercial paper is a "security" within the meaning of the Glass-Steagall Act, a conclusion that has no relevance in this case.[7]

2. Petitioners' lengthy assertion that the FDIC's action here is part of a concerted administrative attempt to thwart the will of Congress (Pet. 6-12) is plainly without merit. This argument simply fails to take into account either the language and history of the Glass-Steagall Act or this Court's decisions under the Act, all of which make it clear that the FDIC's interpretation is the only one that is consistent with

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[6] Petitioners' suggestion (Pet. 13) that the legislative background demonstrates a congressional intent in Section 21 to treat banks and their affiliates as single entities is thus flatly inconsistent with the statutory language and legislative history, and with this Court's holding in *Board of Governors* v. *Investment Co. Institute*, *supra*.

[7] On remand from this Court's decision in *Securities Industry Ass'n*, the court of appeals held that a bank's distribution of commercial paper does not constitute an unlawful underwriting under the Glass-Steagall Act. 807 F.2d 1052 (D.C. Cir. 1986). This Court declined to review that decision. No. 86-1429 (June 22, 1987).

the statute. Indeed, Congress expressly recognized the FDIC's approach in recent comprehensive banking legislation, which was signed into law on August 10, 1987. Competitive Equality Banking Act of 1987, Pub. L. No. 100-86. Section 103 of that law subjects the securities affiliations of insured nonmember banks to Sections 20 and 32 of the Glass-Steagall Act until March 1, 1988; affiliations established prior to March 5, 1987, are not affected. See H.R. Conf. Rep. 100-261, 100th Cong., 1st Sess. 17 (1987). The Conference Report notes that the affiliate restrictions of Sections 20 and 32 currently "do not apply to nonmember banks," and explains that the moratorium legislation is intended to maintain the status quo as to the activities of the affiliates of such banks (H.R. Conf. Rep. 100-261, *supra*, at 134).

In Section 203 of the recent legislation, moreover, Congress expressed its intent "to conduct a comprehensive review of our banking and financial laws and to make decisions on the need for financial restructuring legislation in the light of today's changing financial environment * * * before the expiration of [the March 1988] moratorium." H.R. Conf. Rep. 100-261, *supra*, at 35. In these circumstances, it is petitioners, not the FDIC, who are attempting to disrupt the legislative scheme, and who are attempting to use litigation to thwart or influence the ongoing legislative process.[8]

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[8] Petitioners are simply incorrect in asserting (Pet. 7) that the FDIC's regulation involved a change in administrative position. The FDIC has not expressed the view that the affiliation of insured nonmember banks with securities firms violates the Glass-Steagall Act; to the contrary, as the FDIC informed the court of appeals, between 1969 and 1986 there

3. Petitioners' final contention—that the FDIC regulation sanctions "unsafe and unsound" banking practices in violation of the Federal Deposit Insurance Act (Pet. 17-19)—also lacks merit. As the court below recognized, this assertion is based on the assumption that Congress, in enacting Section 21 of the Glass-Steagall Act, meant to indicate that it was per se an unsafe practice for nonmember banks to affiliate with securities firms (see Pet. 18). As we explain above, however, Section 21 does not bar such affiliations, and therefore can hardly be read to express a congressional view that such affiliations invariably raise safety concerns. And petitioners have not even attempted to demonstrate that the FDIC's stringent regulation fails to obviate whatever risks are associated with securities-dealing by affiliates or subsidiaries of nonmember banks.

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were 28 instances in which securities firms affiliated themselves with insured nonmember banks without objection from the FDIC. Petitioners also are incorrect in suggesting that the Securities and Exchange Commission (SEC) has challenged the validity of the FDIC's regulation (Pet. 7 n.8). In fact, the SEC, which has recognized that the issue here is within the FDIC's area of expertise (see Pet. App. 194a), has expressed no formal view on the FDIC regulation. See generally *FDIC Securities Proposal and Related Issues: Hearings Before the Subcomm. on Telecommunications, Consumer Protection, and Finance of the House Comm. on Energy and Commerce*, 98th Cong., 1st Sess. 44 (1983) (testimony of Chairman John Shad).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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